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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

ALOE VERA OF AMERICA, INC., et al.)	No. 99-1794-PHX-ROS
Plaintiffs,	ORDER
vs.	
UNITED STATES OF AMERICA,	
Defendant.	

Introduction

On October 6, 1999, Plaintiffs: Aloe Vera of America, Inc., (“AVA”), a Texas corporation, Rex G. Maughan (“Maughan”) and Ruth Maughan, husband and wife, Maughan Holdings, Inc., an Arizona corporation, Gene Yamagata, (“Yamagata”), an individual, and Yamagata Holdings, Inc., a Nevada corporation, (“Plaintiffs”), filed a Complaint against the United States of America (“Defendant” or the “Government”), under the Internal Revenue Code (the “IRC”), 26 U.S.C. § 7431(a)(1). Plaintiffs seek to recover civil damages from Defendant for the alleged unauthorized disclosure of tax returns and attendant information by officers and employees of Defendant, through the Internal Revenue Service (the “IRS”), in violation of 26 U.S.C. § 6103. In the Complaint, Plaintiffs allege that the Government has waived sovereign immunity in this action, pursuant to 26 U.S.C. §§ 6103 and 7431.

On December 30, 1999, Defendant filed a Motion to Dismiss for lack of subject matter jurisdiction, pursuant to Fed. R. Civ. P. 12(b)(1), and for failure to state a claim under Fed. R. Civ. P. 12(b)(6). Plaintiffs filed a Response on January 24, 2000, and Defendant filed a Reply on February 10, 2000.¹ The Court heard oral argument on July 10, 2000. At the conclusion of oral argument, Plaintiffs' counsel moved for leave to amend the Complaint in the event the Court finds it deficient.

Facts

The Complaint makes the following factual allegations. Maugham owns or has a substantial ownership interest in a group of associated entities, the Forever Living Products companies (“FLP Group” or the “Group”), some of which are domestic and some foreign. The FLP Group is one of the largest world suppliers of health and beauty products based on the aloe vera plant. The FLP Group is vertically integrated from plantations that grow aloe, through shipping, processing, manufacturing, marketing and sales. Several million distributors worldwide are involved in the distribution of the Group’s products. The distributing entity in Japan, FLP Japan, Ltd., (“FLPJ”) is owned indirectly by Maugham and Yamagata, in equal parts.² AVA is one of the entities within the FLP Group and “is among a handful of U.S. owned entities which have been extremely successful in Japan and which pay significant tax liabilities to the Japanese Government.” (Compl. ¶ 16.) In tax year 1995, FLPJ paid an equivalent of \$26,512,085 in national, prefecture, i.e., district, and local income taxes in Japan. Id.

In the summer of 1996, the IRS proposed to the Japanese National Tax Administration (the “NTA”) a Simultaneous Examination involving United States taxpayers AVA, Maughan, and Yamagata and the Japanese taxpayer, FLPI. (Compl. ¶ 17.) On August 5 and 6, 1996, nine representatives of the IRS met with the six NTA officials in Phoenix, Arizona. During that time, the IRS “disclosed vast amounts of information and voluminous documents to the NTA,” which, in the most part, “upon information and belief, constituted tax

¹ The parties obtained extensions of time to file their respective pleadings.

² Maugham Holdings owns 50% of FLJP and Yamagata Holdings owns the other 50%.

1 returns and return information of Plaintiffs, within the meaning of [26] § 6103(b).” (Compl.
2 ¶ 19.) Approximately on August 15, 1996, the IRS notified Maughan and AVA that a
3 Simultaneous Examination with the NTA was being conducted for the years 1991 through
4 1995. (Compl. ¶ 20.) At least one more meeting was held between the IRS and the NTA
5 officials, in Tokyo, Japan, on November 13-15, 1996, during which additional information was
6 disclosed by the IRS to the NTA, which “upon information and belief constituted tax returns
7 and return information of plaintiffs, within the meaning of 26 U.S.C. § 6103(b).” (Compl. 21.)
8 Thereafter, a Simultaneous Examination Audit plan (the “Audit Plan”) proposed by the IRS to
9 NTA was accepted by the latter and executed by both agencies. (Compl. ¶ 22.) In late 1996,
10 Mr. Kobayashi of the NTA, Tokyo Regional Taxation Bureau (“TRTB”), “threatened
11 representatives of Plaintiffs and FLPJ with a press leak when attempting to coerce FLPJ and
12 Plaintiffs into accepting the audit proposal made by the TRTB.” (Compl. ¶ 23.) The FLPJ did
13 not accept the proposal and, on January 20, 1997, the NTA issued Correction notices to FLPJ
14 in the amount of approximately 8 billion yen, i.e., approximately 73 million U.S. dollars.
15 (Compl. ¶ 24.) On February 5, 1997, the IRS issued a thirty-day notice for 1991 and 1992 to
16 Maughan and AVA. (Compl. ¶ 25.) On December 22, 1997, the NTA issued Correction
17 Notices to FLPJ for 1996 in the amount of approximately 2 billion yen, i.e., approximately 20
18 million U.S. dollars. (Compl. ¶ 26.)

19 Plaintiffs allege that

20 The IRS Audit Plan was incorrect, erroneous, and flawed as a matter of
21 U.S. domestic tax law, international tax law, the U.S.- Japan Tax Treaty,
22 and the Organization for Economic Cooperation and Development
23 (“OECD”) guidelines for transfer pricing. The IRS Audit Plan
24 intentionally ignored appropriate transfer pricing analysis; the effects
of the U.S. and Japanese adjustments proposed as a result of the
Simultaneous Examination was to impose double taxation of income
in contravention of the U.S.- Japan Income Tax Treaty.

25 (Compl. ¶¶ 27-28.) According to the Complaint, the primary issue was the NTA’s
26 characterization of “certain contract amounts paid by AVA to Maughan and Yamagata on the
27 sale of AVA products to FLPJ,” which the NTA characterized as income in the form of a
28 director’s bonus, coming directly from FLPJ, while the same amounts had been reported by

1 AVA in the United States as taxable income. (Compl. ¶ 30.) The IRS did not consider these
2 contract payments made by AVA to Maughan and Yamagata as ordinary and necessary business
3 expenses and, consequently, disallowed deduction of these amounts under 26 U.S.C. § 162(a).
4 Id. As a result of such treatment of these payments, over \$100 million in additional income
5 was shifted from the United States to Japan, increasing FLPJ's profit margin and tax liability
6 in Japan for the audit years 1991-1995. Id.

7 Plaintiffs further allege, that Defendant, in violation of standard IRS procedure, did
8 not consult the U. S. Competent Authority, located in Washington, D.C., which is responsible
9 for preventing double taxation under several U.S. Income Tax Treaties, and that the Audit Plan
10 was not approved by the U.S. Competent Authority. (Compl. ¶ 32.) On March 24, 1997, the
11 FLP Group requested Competent Authority Assistance, which request was granted. (Compl.
12 ¶ 33.) The U.S. taxpayers contested the tax audit adjustments. (Compl. ¶ 34.) At the end of
13 August 1997, the IRS Appeals Officer in Phoenix, Arizona, conceded the primary
14 Simultaneous Examination issue and the proposed \$32 million income increase to AVA for
15 1991 and 1992. The concession was issued in writing, on or about October 24, 1997. (Compl.
16 ¶ 35.)

17 To date, despite the efforts of the U.S. Competent Authority, the Japanese
18 Competent Authority refuses to accept that this matter involves the U.S.-Japan Tax Treaty and
19 "continues to erroneously insist that the matter is wholly one of internal Japanese Taxation and
20 that transfer pricing is not relevant to the resolution of the issue." (Compl. ¶ 36-37.)
21 Plaintiffs allege that the NTA's position is a result of the improper actions by the IRS
22 described in the Complaint. Id. Specifically, Plaintiffs allege that

23 The IRS . . .disclosed false information to the NTA in an attempt to
24 improperly and irrevocably prejudice the NTA against plaintiffs and
25 FLPJ, (including but not limited to the following), to wit:
26 (a) That the United States and Japanese taxpayers committed fraud;
27 (b) That commission payments by AVA to Rex Maughan and Gene
28 Yamagata on AVA sales to FLPJ remained unchanged over the years
although cost of product to FLPJ changed;
(c) That Rex Maughan made a decision to move income and assets
from and out of FLP, Inc. so that a tax deficiency due to the IRS could
not be collected;

1 (d) That Rex Maughan set up the “Batrax System”³] tax shelter
2 designed to bring income into the United States from other countries
3 without paying tax; and
(e) That the FLP Group has built much wealth by not paying taxes and
that FLP was not in compliance with the U.S. tax laws.

4 (Compl. ¶ 39.) Plaintiffs further allege that all of these statements were presented to the NTA
5 as facts, though they were “unverified, unsubstantiated, inaccurate, and [the] false position of
6 the IRS calculated to produce the desirable Simultaneous Audit result, which was double
7 taxation.” (Compl. ¶ 40.) Plaintiffs allege that the IRS either knew or should have known that
8 the statements were false, and that, as a result of the IRS’s actions, on October 9 and 10, 1997,
9 Japanese media published numerous stories about the FLPJ tax deficiencies. These stories
10 appeared on Japanese national radio and television and in all five of the major Japanese
11 newspapers with national circulation. The stories were also picked up by the International
12 Press and reported in the United States. (Compl. ¶ 43.) “The stories contained extensive
13 return information as well as numerous false and inflammatory statements and were ascribed
14 ‘to those involved in the audit.’” (Compl. ¶ 44.)

15 The IRS has denied any leaks to the Japanese press. (Compl. ¶ 45.) Plaintiffs
16 allege that the IRS knew or should have known the NTA’s practice of leaking confidential tax
17 information to the press, which is allegedly routinely used by the NTA in order to either
18 coerce a taxpayer or create prejudice against it. (Compl. ¶ 49.) “Based on the press leak and
19 complaints by U.S. taxpayers Rex Maughan and AVA, John Lyons, the IRS Assistant
20 Commissioner International and the U.S. Competent Authority first suspended and then
21 terminated the Simultaneous Examination between Japan and the United States regarding the
22 U.S. taxpayers Rex Maughan and AVA and the Japanese taxpayer FLPJ.” (Compl. ¶ 53.)
23 Plaintiffs allege that the FLPJ “has been harmed as a direct and proximate result of the
24 unauthorized disclosure of false information by, inter alia, declining sales, by damaged
25 reputation, by a decline in new distributor applications, and a decline in existing distributor
26 participation in the sale of AVA products through FLPJ.” (Compl. ¶ 73.) Plaintiffs allege that

27
28 ³ None of the parties offer a definition or explanation of what is the “Batrax System.”

1 AVA has been harmed, because FLPJ has not paid it royalties timely, and has not increased
2 orders of AVA products as it should have based on historical data, and these orders actually
3 declined. (Compl. ¶ 74.) Maughan Holdings has been damaged through decline in stock value
4 and dividends. (Compl. ¶ 75.) Maughan, who is the sole shareholder of AVA and a 50%
5 shareholder of FLPJ through Maughan Holdings has been damaged “in an amount to be
6 established at trial.” (Compl. ¶ 76.) Yamagata Holdings, a 50% shareholder of FLPJ has been
7 damaged through decline in stock value and dividends. (Compl. ¶ 77.) Yamagata, a 50%
8 shareholder of FLPJ through Yamagata Holdings has been damaged “in an amount to be
9 established at trial.” (Compl. ¶ 78.) In addition to the economic damages Plaintiffs also seek
10 punitive damages, alleging that the conduct of the IRS was knowing, willful and/or grossly
11 negligent. (Comp. ¶ 79.)

12 The Complaint alleges two causes of action: (1) unauthorized disclosure of false
13 information; and (2) illegal Japanese disclosure.⁴

14 Discussion

15 Defendant seeks dismissal under both Fed. R. Civ. P. 12(b)(1), for lack of subject
16 matter jurisdiction, and under Fed. R. Civ. P. 12(b)(6), for failure to state a claim. Defendant
17 makes four arguments: (1) the Court lacks subject matter jurisdiction because Plaintiffs’ failed
18 to bring this action timely, (Mot. at 5); (2) disclosures made by the NTA do not bring this suit
19 within the sovereign immunity waiver under 26 U.S.C. § 7431(a)(1), which requires
20 unauthorized disclosure by an employee of the United States,⁵ (Mot. at 4); (3) disclosures by
21 the IRS to the NTA were authorized by 26 U.S.C. § 6103(k)(4); (4) Plaintiff’s first cause of
22
23

24 ⁴ By the latter the Complaint appears to mean disclosure of Plaintiffs’ actual tax return
25 information by the IRS to the Japanese NTA and not by the NTA to the press. (Compl. ¶¶ 42,
26 67-72.) The NTA is not a party to this action.

27 ⁵ This argument was based on Defendant’s perception that by “Illegal Japanese
28 Disclosure” the Complaint meant disclosure by the NTA to the press. The text of the
Complaint does not allege this, the unclear title of Count II notwithstanding.

1 action lies in tort because it is a disguised action for libel or slander, over which the Court has
2 no jurisdiction. (Mot. at 12.)

3 In Response Plaintiffs argue that the government waived sovereign immunity and
4 in particular (1) the action was brought within two years after Plaintiffs discovered that the IRS
5 was the source of the information disclosed to the NTA, and therefore it is timely; (2)
6 Plaintiff's Complaint is not based on disclosures made by the NTA to the media but on
7 disclosures made by the IRS to the NTA; (3) the disclosures were unauthorized by the statute
8 because they did not fall within the parameters of the secrecy requirement of the treaty
9 between the United States and Japan; and (4) Plaintiffs' action is for unauthorized disclosure
10 and not for libel.

11 **1. Defendant's Motion to Dismiss for lack of subject matter jurisdiction.**

12 Rule 12(b)(1) provides that "[e]very defense, in law or fact, to a claim for relief in
13 any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be
14 asserted in the responsive pleading thereto if one is required, except that the following
15 defenses may at the option of the pleader be made by motion; (1) lack of jurisdiction of the
16 subject matter . . ." Fed. R. Civ. P. 12(b)(1). The burden is on Defendant to establish that this
17 defense exists.⁶ But if the statute is jurisdictional, it is Plaintiffs' task to present the Court
18 with sufficient information to allow the Court to make the determination whether the action
19 is timely. Plaintiffs allege jurisdiction pursuant to 26 U.S.C. § 7431(a) and 28 U.S.C. § 1331.
20 However, the Court will not assume that the allegation of jurisdiction is accurate but will
21 examine it independently. Roberts v. Corrothers, 812 F.2d 1173, 1177 (9th Cir.1987).

22 It is well established that the United States cannot be sued unless it unequivocally
23 consents to the suit. United States v. Nordic Village, Inc., 503 U.S. 30, 33-34 (1992) (citing
24 Department of Veterans Affairs, 498 U.S. 89, 95 (1990) (quoting in turn United States v.
25 Mitchell, 445 U.S. 535, 538 (1980), and United States v. King, 395 U.S. 1, 4 (1969))).

26
27 ⁶ The Court may also raise the issue sua sponte. See Fed.R.Civ.P. 12(h); Mt. Healthy
28 City Sch. Dist. Bd. of Educ. v. Doyle, 429 U.S. 274, 278 (1977).

1 Consequently, “the Government’s consent to be sued ‘must be construed strictly in favor of
2 the sovereign, and not enlarg[ed] . . . beyond what the language requires.’” Id. (citing McMahon
3 v. United States, 342 U.S. 25, 27 (1951); and Ruckelshaus v. Sierra Club, 463 U.S. 680, 685,
4 (1983) (quoting Eastern Transportation Co. v. United States, 272 U.S. 675, 686 (1927))).

5 Defendant argues that Plaintiffs have not satisfied the conditions for establishing
6 the waiver of sovereign immunity set forth in the statute they invoke, 26 U.S.C. § 7431. The
7 statute provides:

8 Inspection or disclosure by employee of United States.--If any officer
9 or employee of the United States knowingly, or by reason of
10 negligence, inspects or discloses any return or return information with
11 respect to a taxpayer in violation of any provision of section 6103,
12 such taxpayer may bring a civil action for damages against the United
13 States in a district court of the United States.

14 26 U.S.C. § 7431(a)(1). Thus, § 7431 requires that a disclosure by the IRS officer or
15 employee be made in violation of 26 U.S.C. § 6103. That statute provides in part:

16 (a) General rule.--Returns and return information shall be confidential,
17 and except as authorized by this title--
18 (1) no officer or employee of the United States,
19
20 shall disclose any return or return information obtained by him in any
21 manner in connection with his service as such an officer or an
22 employee or otherwise or under the provisions of this section. For
23 purposes of this subsection, the term “officer or employee” includes
24 a former officer or employee.

25 26 U.S.C. § 6103 (a). Additionally, there is a limitation period within which any action under
26 26 U.S.C. § 7431(a)(1) may be brought, that is two years after the plaintiff discovers the
27 unauthorized disclosure:

28 Period for bringing action.--Notwithstanding any other provision of
law, an action to enforce any liability created under this section may
be brought, without regard to the amount in controversy, at any time
within 2 years after the date of discovery by the plaintiff of the
unauthorized inspection or disclosure.

26 U.S.C. § 7431(d). Defendant asserts that, even if the unauthorized disclosures occurred,
which Defendant does not concede, Plaintiffs failed to file their Complaint within the
statutorily allowed time. Further, Defendant argues that because the terms and conditions
imposed by the statute define the Court’s jurisdiction over this matter, the Court is without

1 jurisdiction to entertain Plaintiffs' action. (Mot. at 5-8.) Specifically, Defendant argues that
2 because Plaintiffs did not allege in their Complaint that they became aware of the unauthorized
3 disclosures within two years of bringing this action, the action is barred. (Mot. at 7.)

4 In support of this argument, Defendant cites two unpublished district court cases:
5 Detrick v. United States, WL 28887 *3 (D. Or. Jan. 23, 1991), aff'd on other grounds, 962
6 F.2d 13 (9th Cir. 1992) and Pack v. United States, 1991 LEXIS 15523 (E. D. Cal. October 11,
7 1991). The latter case involved a motion for summary judgment not a motion to dismiss:
8 "Although plaintiff alleges in his complaint that he learned of the . . . disclosures within the last
9 two years, he has not submitted any admissible evidence to show [it]." Id. Here, however,
10 because Defendant moved to dismiss and not for summary judgment, the question is not
11 whether Plaintiffs can or have proved the timeliness of their case but whether the allegation
12 of timeliness in the Complaint is sufficient. Further, in Detrick, the plaintiffs alleged
13 unauthorized disclosures pursuant to a statute which "appear[ed] to correspond to the filing of
14 notices of a federal tax lien and the service of notice of levy." WL 28887 *2. The plaintiffs
15 in Detrick did not and could not allege, as the Plaintiffs here assert, that they discovered the
16 alleged disclosures long after the disclosures were made, because the facts established that
17 they had actual knowledge that the notices were issued by the IRS at the time they were issued.
18 The court held that to the extent the notices did contain unauthorized disclosures, because they
19 were issued more than two years before the plaintiffs filed their complaint, plaintiffs' action
20 under 26 U.S.C. § 7431 was time barred. Id. * 3.⁷ Affirming the district court's order (also
21 in an unpublished decision), the Ninth Circuit held that the disclosures in notices of federal
22 tax lien and levy were authorized by 26 U.S.C. § 6103(k)(6), and, therefore, did not discuss

24 ⁷ The Detrick court stated that the limitations period under 26 U.S.C. § 7431(d)
25 "begins to run from the date upon which the plaintiff knows or should have known of the
26 subject injury." Detrick, WL 28887 *2. The cases the court cited in support of this legal
27 standard, however, all arose under either 42 U.S.C. § 1981 or under 42 U.S.C. § 1983, and not
28 under the Internal Revenue Code. The statute applicable here, 26 U.S.C. § 7431(d), establishes
the two year limitation period from the time the plaintiff "discovers" the unauthorized
disclosure, rather than from time the plaintiff "should have known" of the injury.

1 the district court's holding that the claim was time barred and, therefore, outside of the court's
2 jurisdiction.

3 In Ancor Capital Corp. v. United States, 1995 WL 515690 (C.D. Cal. June 13,
4 1995), another unpublished opinion upon which Defendant relies, the court--converting a
5 motion to dismiss into one for summary judgment--found that, though plaintiff alleged that it
6 did not discover the unauthorized disclosure until 1994, several documents in the record, and
7 specifically plaintiff's own letters and internal memoranda, demonstrated that the plaintiff
8 knew of the alleged unlawful disclosure more than two years before the complaint was filed.
9 In the case at bar, however, there are no documents in the record before the Court allowing it
10 to make such a finding.

11 Plaintiffs assert that Defendant is aware of the exact date when Plaintiffs
12 discovered that the IRS made the allegedly unauthorized disclosures, having finally disclosed
13 on the documentation of the disclosures made to the NTA, pursuant to Judge Carroll's order
14 issued on August 7, 1998 against Defendant in another case filed by Plaintiffs, under the
15 Freedom of Information Act ("FOIA").⁸ Further, during oral argument, Plaintiffs' counsel
16 pointed out that Fed. R. Civ. P. 8(c), which guides pleading of the affirmative defenses,
17 supports the notion that it is a defendant's duty to plead the statute of limitations as a defense.
18 Id.

19 The Complaint does not expressly state that the discovery was made within two
20 years of Plaintiffs' action. This deficiency in Plaintiffs' pleading, will only bar this action if
21 the Court finds that § 7431(d) is jurisdictional and as a result Plaintiffs were obligated to
22 establish in their Complaint that its cause of action accrued within two years before filing.⁹
23

24 ⁸ On June 29, 1998, Judge Carroll ordered the IRS to release all requested documents
25 on or before August 13, 1998, unless it showed cause why the documents should not be
26 released. The IRS released a portion of the requested documents on August 7, 1998. (Resp.
at 5-6.)

27 ⁹ In such case, Plaintiffs would be allowed to amend their Complaint to insert the
28 allegation of timeliness, and they could do it in good faith given the facts surrounding

1 **A. Whether § 7431(d) is jurisdictional.**

2 Defendant mentions, in a footnote, that “[t]here is some question in the Ninth
3 Circuit whether statutes of limitation regarding actions against the United States remain
4 jurisdictional after the Supreme Court held in Irwin v. Department of Veteran Affairs, 498 U.S.
5 89, 95-96 (1990) that such statutes of limitation may, in rare instances, be equitably tolled.”
6 (Mot. at 6 n.2.) Defendant points to three Ninth Circuit cases: Nesovic v. United States, 71
7 F.3d 776, 777-78 (9th Cir. 1995), which holds that the plaintiff’s failure to sue the United
8 States within the statutory period of limitations deprives the district court of jurisdiction to
9 consider the action; UOP v. United States, 99 F.3d 344, 347 (9th Cir. 1996), which holds that
10 28 U.S.C. § 2401(a) is jurisdictional and cannot be waived; and Cedars-Sinai Medical Ctr. v.
11 Shalala, 125 F.3d 765, 770 (9th Cir. 1998), holding that 28 U.S.C. § 2401(a) is not
12 jurisdictional.

13 Cedars-Sinai dispels any doubts what the Ninth Circuit’s position is, after Irwin,
14 on statutes of limitation in cases against the United States. In Cedars-Sinai, the Ninth Circuit
15 said that “earlier statements that statutes of limitations are jurisdictional in nature have no
16 continuing validity after the Court’s decision in Irwin,”¹⁰ and, unless “the language of a statute
17 of limitations [speaks] of jurisdiction,” the statute is not jurisdictional. 125 F.3d at 770.

18 The statute at issue here, 26 U.S.C. § 7431(d), “does not speak of jurisdiction, but
19 erects only a procedural bar,” Cedars-Sinai, 125 F.3d at 770, when it provides that actions
20 under that section of the IRC “may be brought, without regard to the amount in controversy,
21 at any time within 2 years after the date of discovery by the plaintiff of the unauthorized

22 _____
23 Plaintiffs’ discovery of who made the disclosures at issue, as discussed in more detail later
24 herein.

25 ¹⁰ Irwin involved a suit brought pursuant to Title VII. The Ninth Circuit cases cited by
26 Defendant involve statute of limitations under FTCA, 28 U.S.C. § 2401(a), which “is the
27 catchall statute of limitations provision,” see Nesovic, 71 F.3d at 777, which provides in
28 relevant part that “. . . every civil action commenced against the United States shall be barred
unless the complaint is filed within six years after the right of action first accrues.” 28
U.S.C. § 2401(a).

1 inspection or disclosure.” 26 U.S.C. § 7431(d). Based on Irwin and Cedars-Sinai, the Court
2 finds that § 7431(d) is not jurisdictional.

3 In their Response to Defendant’s Motion to Dismiss, Plaintiffs do not separately
4 discuss whether the statute is jurisdictional or procedural, and do not discuss the cases cited
5 by Defendant in support of its argument on this issue,¹¹ but concentrate on rebutting
6 Defendant’s allegation that the statute has run, by arguing facts which may establish that they
7 discovered the disclosure and filed the Complaint within the statutory two year time period.
8 The resolution of this remaining allegation in Defendant’s Motion to Dismiss, under Rule
9 12(b)(1), requires that the Court decide whether Plaintiffs’ action was untimely filed and,
10 therefore procedurally barred. That, in turn, depends on the determination of when did
11 Plaintiffs’ cause of action accrue.

12 **B. When did Plaintiffs’ cause of action accrue.**

13 Pursuant to the statute, an action for unauthorized disclosure may be brought “within 2
14 years after the date of discovery by the plaintiff of the unauthorized inspection or disclosure.”
15 26 U.S.C. § 7431(d). Defendant points out that, according to the Complaint, the allegedly
16 unauthorized information was disclosed by the representatives of the IRS to the representatives
17 of the NTA on two occasions: first, during meetings held in Phoenix, on August 5 and 6, 1996,
18 (Compl. ¶ 19), and then, during meetings held on November 13 through 15, 1996, in Tokyo.
19 (Compl. ¶ 21.) These meetings occurred more than two years prior to Plaintiffs’ filing of the
20 Complaint. As previously noted, in its Motion to Dismiss, Defendant emphasizes that
21 Plaintiffs have not alleged that they “discovered” the allegedly unauthorized disclosures less
22 than two years before filing their Complaint. (Mot. at 7) (citing 26 U.S.C. § 7431(d)).
23 Defendant further argues:

24
25 ¹¹ Addressing the issue of statute of limitations, in a footnote, Plaintiffs make a general
26 statement that the “cases cited by Defendant on this issue are distinguishable because, inter
27 alia, none involved a situation where the Defendant concealed the wrongful conduct at issue.”
28 (Resp. at 5 n. 5.) It is unclear whether Plaintiffs refer to the cases which Defendant cites in
its discussion of jurisdictional matter or to the accrual of the cause of action.

1 In fact, plaintiffs own allegations establish clearly that they discovered
2 the alleged disclosures more than two years before bringing this suit.
3 Plaintiffs allege that the IRS notified them of the Simultaneous
4 Examination being conducted by the IRS and the NTA on or about
5 August 15, 1996. Plaintiffs further assert that the NTA threatened
6 them in late 1996 with a press leak if they did not accept an audit
proposal made by the NTA's Regional Tax Bureau. Finally, plaintiffs
allege that, on January 20, 1997, the NTA issued Correction Notices
in furtherance of the Simultaneous Examination. Thus, plaintiffs knew
on or before January 1997 that the IRS had made the alleged
disclosures.

7 (Mot. at 7-8.) In Response, Plaintiffs state that "[t]here is no dispute that the two-year period
8 does not begin to run until after Plaintiffs discover the unauthorized disclosure." (Resp. at 5,
9 citing Mot. at 3.) Plaintiffs further state:

10 Defendant argues, without logical support, that plaintiffs discovered
11 the alleged disclosures more than two years before bringing the suit.
12 Defendant first points to the allegation that on or around August 15,
13 1996, the IRS notified Plaintiffs of the simultaneous examination
14 being conducted by the IRS. Nothing about this notification gave
15 taxpayers any possible indication of unlawful disclosures made by IRS
employees during this examination. In the same vein, the threats from
the NTA in late 1996, and the issuance of correction notices by the
NTA in January of 1997, gave Plaintiffs no possible indication that the
IRS was responsible for making unlawful disclosures or false
statements to the NTA.

16 (Resp. at 7 n.7.) Finally, Plaintiffs claim that it was only after they received the documents
17 from Defendant, on or about August 13, 1998, the release of which was ordered by Judge
18 Carroll, that they discovered the unauthorized disclosures by the IRS to the NTA. Thus, the
19 Complaint was filed less than two years thereafter. (Resp. at 7.)

20 The Court finds that Plaintiffs' position is not inconsistent with the allegation made
21 in the Complaint that much of the information which appeared in the press reports was known
22 only to the IRS and the NTA. (Compl. ¶ 46.) If the press publications contained only actual
23 information known only to the IRS and--presumably as a result of the simultaneous
24 examination--to the NTA, then, arguably, Plaintiffs would have known at the time the reports
25 were published that the IRS made an allegedly unlawful disclosure. But it is unclear at this
26 time precisely what information allegedly disclosed by the IRS was published from the press
27 releases, and what part of it was derived from the actual tax return information allegedly
28

1 disclosed by the IRS. The Court must await completion of discovery for resolution of this
2 issue.

3 Defendant also argues that Plaintiffs' cause of action accrued long before the
4 discovery provided by its FOIA case, citing United States v. Kubrick, 444 U.S. 111 (1979).
5 Defendant argues that "[i]n a case far more sympathetic to a plaintiff than the present case, the
6 Supreme Court held that a veteran's action for medical malpractice accrued for statute of
7 limitation purposes once he was aware of his injury and that the probable cause of injury was
8 treatment at a Veterans Administration hospital, even though he did not learn till later that the
9 injury was negligently inflicted as a matter of law." (Rpl. at 4). The Court finds that Kubrick
10 is distinguishable. There, the Supreme Court held that a cause of action under the FTCA
11 accrues when a plaintiff is aware of his injury and the probable cause of such injury. Id. at 121.
12 The Supreme Court distinguished between a plaintiff's knowledge of his legal rights and his
13 knowledge of the injury and its cause:

14 We are unconvinced that for statute of limitations purposes a
15 plaintiff's ignorance of his legal rights and his ignorance of the fact of
16 his injury or its cause should receive identical treatment. That he has
17 been injured in fact may be unknown or unknowable until the injury
18 manifests itself; and the facts about causation may be in the control of
the putative defendant, unavailable to the plaintiff or at least very
difficult to obtain. The prospect is not so bleak for a plaintiff in
possession of the critical facts that he has been hurt and who has
inflicted the injury.

19 Id. at 122. To the extent the same reasoning may apply to causes of action accruing under 26
20 U.S.C. § 7431, Plaintiffs in the case at bar were allegedly in the position of one who may have
21 learned that the injury occurred when the press reports were published, but the actual cause,
22 i.e., the alleged illegal disclosure by the IRS, arguably, may not have occurred until Judge
23 Carroll mandated the release of the pertinent documents by the IRS to Plaintiffs in 1998.

24 At oral argument, Defendant further argued that the recently decided Rotella v.
25 Wood, ___ U.S. ___, 120 S. Ct. 1075 (2000) lends additional support to the argument that the
26 discovery of the injury is the accrual date of the statute of limitations pursuant to 26 U.S.C. §
27 7431. Defendant's reliance on Rotella is misplaced. In that case, the plaintiff was admitted to
28 a psychiatric hospital in 1985 and released in 1986. In 1994, the hospital's parent company

1 and one of its directors pleaded guilty to criminal fraud charges stemming from illegal
2 agreements with the doctors. In 1997, Plaintiff brought an action under the federal civil RICO
3 statute, 18 U.S.C. § 1961-1968, which does not include a limitations provision. A unanimous
4 Supreme Court held that the civil RICO claim accrues when a plaintiff discovers his injury,
5 not when the second or any subsequent act of racketeering occurs, which is consistent with the
6 wording of the statute. 120 S. Ct. at 1080. The Supreme Court did not depart from its holding
7 in Kubrick. Consequently, Rotella does not alter the Court's analysis in the case at bar.

8 Finally, Defendant argues that Plaintiffs failed to provide "a verified statement that
9 they discovered the unlawful disclosures within the two-year limitations period. Instead they
10 produced a 'tale . . . full of sound and fury signifying nothing.'" (Rpl. at 3.) Defendant does not
11 offer any authority requiring Plaintiffs to provide a verified statement in the Complaint.

12 The above discussion notwithstanding, the Complaint alleges that the two meetings
13 during which the IRS allegedly made unauthorized disclosures took place on August 5-6, 1996,
14 and on November 13-15, 1996. The Complaint was filed on October 6, 1999, more than two
15 years after the last of the two meetings. Consequently, on its face, by failing to plead the date
16 of discovery of the alleged unauthorized disclosures, the Complaint presently supports
17 Defendant's argument that this action is untimely and, therefore, Defendant's Motion to
18 Dismiss will be granted. However, during oral argument, Plaintiffs offered a factual
19 explanation supporting their position that the Complaint was not untimely filed and moved for
20 leave to amend.¹² Because the defect in the Complaint may be cured by the amendment, the
21 Court will grant Plaintiffs' Motion for Leave to Amend, to allege, if they can do it in good
22 faith, facts in support of their contention that they did not discover the alleged unauthorized
23 disclosures until the IRS responded to Judge Carroll's order in Plaintiff's FOIA case.

24 **2. Defendant's Motion to Dismiss for failure to state a claim**

26
27 ¹² The Court cannot find at this time that the amendment would be futile as Defendant
28 alleges. The Court may reconsider after appropriate discovery is completed and the issue has
been properly briefed by motion.

1 Defendant also alleges that Plaintiffs failed to state a claim for which relief may be
2 granted, because the disclosures made by the IRS to the NTA were authorized by statute, and
3 specifically by 26 U.S.C. § 6103(k)(4).

4 **A. Legal standard.**

5 Defendant invokes Fed. R. Civ. P. 12(b)(6). “The motion to dismiss for failure to state a
6 claim is viewed with disfavor and is rarely granted.” Gilligan v. Jamco Development Corp.,
7 108 F.3d 246, 249 (9th Cir. 1997) (internal quotation marks omitted). In determining whether
8 a complaint states a claim for which relief can be granted, all allegations of material fact are
9 taken as true and construed in the light most favorable to the Plaintiff. Enesco Corp. v.
10 Price/Costco Inc., 146 F.3d 1083, 1085 (9th Cir. 1998). Dismissal under Rule 12(b)(6) is
11 proper only when looking at the complaint and any materials attached to the complaint, the
12 court finds no possible set of facts which could support the stated claim; in other words, the
13 complaint should not be dismissed for failure to state a claim unless it appears beyond doubt
14 that the Plaintiff can prove no set of facts in support of his claim which would entitle him to
15 relief. Morley v. Walker, 175 F.3d 756, 759 (9th Cir. 1999). When deciding a motion to
16 dismiss under Rule 12(b)(6) the Court may consider documents attached to the complaint. See
17 Hal Roach Studios v. Richard Feiner & Co., 896 F.2d 1542, 1555 (9th Cir. 1990) (holding that
18 materials submitted with the complaint may be considered on a motion to dismiss under Fed.
19 R. Civ. P. 12(b)(6)); and cf. Levine v. Diamantheset, Inc., (950 F.2d 1478, 1483 (9th Cir. 1991)
20 (briefs, affidavits, discovery materials may not be considered). If a complaint is dismissed,
21 a plaintiff is entitled to leave to file an amended complaint “unless it is clear . . . that the
22 complaint could not be saved by any amendment.” Griggs v. Pace American Group, Inc., 170
23 F.3d 877, 879 (9th Cir. 1999) (quoting Steckman v. Hart Brewing, Inc., 143 F.3d 1293, 1296
24 (9th Cir. 1998)).

25 **B. Whether Plaintiffs stated a claim for unauthorized disclosure under 26 U.S.C. §§**
26 **6103 and 7431.**

27 Section 6103 of the IRC provides the general rule that “returns” and “return
28 information” are confidential. See 26 U.S.C. § 6103(a) & (b); Long v. IRS, 891 F.2d 222,

223 (9th Cir.1989) (“return information ... is confidential”); Lampert v. United States, 854 F.2d 335, 336 (9th Cir.1988). Section 7431 of the Code created a private cause of action by a taxpayer against the United States for improper disclosure of such information and provides for damages. 26 U.S.C. § 7431. Section 7431 prohibits knowing or negligent disclosure or allowance of inspection of a taxpayer’s return or return information to persons outside the agency unless circumstances arise which fall within one of the exceptions set forth in 26 U.S.C. 6103. Consequently, to state a claim for unauthorized disclosure under 26 U.S.C. § 7431, Plaintiffs must allege “(1) that the disclosure [by IRS] was unauthorized; (2) that the disclosure was made knowingly or by reason of negligence; and (3) that the disclosure was in violation of section 6103.” See Weiner v. Internal Revenue Service, 789 F. Supp. 655, 656 (S.D. N.Y. 1992), aff’d, 986 F.2d 12 (2d Cir.1993) (citing Christensen v. United States, 733 F. Supp. 844, 849 (D. N.J. 1990), aff’d, 925 F.2d 416 (3d Cir.1991); Flippo v. United States, 670 F. Supp. 638, 641 (W.D. N.C. 1987), aff’d, 849 F.2d 604 (4th Cir.1988)).

The statute provides the following definitions which are relevant here:

The term “return information” means--

(A) a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense,

(B) any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110, and

....

The term “taxpayer return information” means return information as defined in paragraph (2) which is filed with, or furnished to, the Secretary by or on behalf of the taxpayer to whom such return information relates.

26 U.S.C. §§ 6103 (b)(1), (2), (3) (emphasis added). The statute also gives a broad definition of a “disclosure” as “the making known to any person in any manner whatever a return or return

1 information.” 26 U.S.C. § 6103(b)(8). As previously stated, the Complaint alleges that the
2 IRS disclosed, in violation of § 6103, the following:

- 3 (a) That the United States and Japanese taxpayers committed fraud;
4 (b) That commission payments by AVA to Rex Maughan and Gene
Yamagata on AVA sales to FLPJ remained unchanged over the years
although cost of product to FLPJ changed;
5 (c) That Rex Maughan made a decision to move income and assets
from and out of FLP, Inc. so that a tax deficiency due to the IRS could
6 not be collected;
7 (d) That Rex Maughan set up the “Batrax System” tax shelter designed
to bring income into the United States from other countries without
paying tax; and
8 (e) That the FLP Group has built much wealth by not paying taxes and
that FLP was not in compliance with U.S. tax laws.

9 (Compl. ¶ 39.)

10 **1. Whether the alleged disclosures constituted return information.**

11 As a preliminary matter, both parties, relying on Mallas v. United States, 993 F.2d
12 1111, 1118 (4th Cir. 1993), appear to agree that disclosure of false information may constitute
13 tax return information within the definition of the statute.¹³ (Mot. at 13 n.6) and (Resp. at 9
14 n. 11.) In Mallas, the IRS sent numerous letters, the so called revenue agents reports (the
15 “RARs”), to plaintiffs’ investors, informing them that plaintiffs were convicted of an illegal
16 tax shelter scheme. The IRS neglected to mention that plaintiffs’ convictions were overturned
17 on appeal. The Fourth Circuit held that the information disclosed to plaintiffs’ investors was
18 false information and that such false information constituted tax return information within the
19 meaning of the statute. The Government argued that the letters to plaintiffs’ investors were not
20 tax return information. The Fourth Circuit disagreed.

21 The Government first argues that the information in the RARs was not
22 “return information” of Mallas and Jones because it was not prepared
by the IRS specifically with respect to their returns. See
23 Government’s Reply Br. at 3 (“[I]nformation about a taxpayer must
have its genesis in an examination or investigation of that taxpayer’s
24 tax liabilities in order to constitute ‘return information.’” (emphasis
added)). This argument simply misconstrues section 6103. “Return
25 information” is expansively defined in 26 U.S.C. § 6103(b)(2)(A) as
“any . . . data . . . prepared by . . . the Secretary with respect to a return
26

27 ¹³ Plaintiff’s citation to Mallas, i.e., Mallas v. United States, 993 F.2d 111, 1118 (4th
28 Cir. 1993) is incorrect. (Resp. at 9 n.11.)

1 or with respect to the determination of the existence, or possible
2 existence, of liability (or the amount thereof) of any person under this
3 title for any tax, penalty, interest, fine, forfeiture, or other imposition,
4 or offense.”

5 Id. at 1118 (emphasize added) (footnote omitted). Thus only data prepared with respect to the
6 return is return information which includes information regarding the false information
7 concerning the status of the taxpayers’ criminal matter. The Fourth Circuit then concluded that
8 the IRS disclosures were not authorized. Id. at 1124.

9 The Fourth Circuit’s characterization of what qualifies as “return information”
10 under the statute is equally applicable in the case at bar as it was applicable in Mallas. Because
11 information disclosed by the IRS to the NTA was “prepared by . . . the Secretary” allegedly
12 “with respect to the determination of the existence, or possible existence, of [tax] liability (or
13 the amount thereof) of [Plaintiffs],”see 26 U.S.C. § 6103(b)(2)(A), such information
14 constitutes “return information” within the definition provided by the statute.

15 The remaining issue is whether the disclosures of Plaintiffs’ return information,
16 which the IRS made to the NTA in the course of the Simultaneous Examinations, were
17 authorized by the statute as a matter of law.

18 **2. Whether the disclosures were authorized by § 6103(4).**

19 Defendant commences its argument with the statement that all disclosures of
20 information the IRS made to the NTA in the case at bar were authorized by § 6103(k)(4), which
21 reads:

22 Disclosure to competent authority under tax convention.--A return or
23 return information may be disclosed to a competent authority of a
24 foreign government which has an income tax or gift and estate tax
25 convention, or other convention or bilateral agreement relating to the
26 exchange of tax information, with the United States but only to the
27 extent provided in, and subject to the terms and conditions of, such
28 convention or bilateral agreement.

Id. (emphasis added). Defendant then points to Article 26 of the “Convention between the
United States of America and Japan for the Avoidance of Double Taxation and the Prevention
of Fiscal Evasion with Respect to Taxes on Income, entered July 9, 1972, TIAS 7365, 1973-1
C.B. 630,” (the “Convention”), (Mot. at 9), which provides for exchange between “the

1 competent authorities of the Contracting States” of “such information as is pertinent to
2 carrying out the provisions of this Convention or preventing fraud or fiscal evasion in relation
3 to the taxes which are the subject of this Convention.” Id. Defendant argues that the
4 simultaneous examination by the IRS and the NTA was conducted pursuant to the Convention
5 with the goal of determining “whether certain transactions between the U.S. taxpayers and the
6 Japanese taxpayer, FLPJ, were being consistently and properly reported to both countries. If
7 they were not, such failure could constitute fraud, fiscal evasion and/or civil underreporting
8 of United States and/or Japanese tax.” (Mot. at 10.) Consequently, Defendant argues, any
9 disclosures the IRS made to NTA in the course of the simultaneous examination was in
10 furtherance of the mutual goal of the two taxing agencies, pursuant to the Convention and
11 authorized by the statute.

12 Plaintiff responds that the applicable provisions of the Convention only apply to
13 disclosure of information pertinent to carrying out the provisions of that Convention or for any
14 fraud or fiscal evasion of taxes, and, therefore, disclosure of false statements are not
15 authorized disclosures because they “could not possibly have any bearing upon the exchange
16 of ‘pertinent information’ between the United States and Japan.” (Resp. at 13.) Plaintiff further
17 responds that the same article of the Convention, on which the IRS relies, provides that any
18 information received within the exchange “shall be treated as secret and shall not be disclosed
19 to any person other than those (including a court or administrative body) concerned with
20 assessment, collection, enforcement, or prosecution in respect of the taxes which are the
21 subject of this Convention.” Id. Further, § 6103(k)(4) uses a permissive “may” rather than the
22 mandatory “shall” when authorizing disclosure to a competent authority of a foreign
23 government, and, therefore, the IRS was not obligated to disclose false return information to
24 the NTA, especially when it knew or should have known that “the Japanese NTA routinely fails
25 to abide by the secrecy provisions of the treaty.” (Resp. 8.)

26 Plaintiff also argues that § 6103(k)(4) allows disclosure of return information to
27 a foreign government “but only to the extent provided in, and subject to the terms and
28 conditions of, such convention.” (Resp. at 7) (quoting § 6103(k)(4). The Convention, in turn,

1 provides that all information exchanged with the foreign government-signatory to the
2 Convention “shall be treated as secret and shall not be disclosed to any person.” Art. 26 (1)
3 of the U.S./Japan Convention. This requirement of secrecy is undoubtedly one of the “terms
4 and conditions” of the Convention. Plaintiff contends that the IRS “knew or should have
5 known” that the NTA does not abide by the Convention’s secrecy requirement and, therefore,
6 violated a non-disclosure statute. (Resp. at 9.)

7 In support of this argument, Plaintiffs cite Jones v. United States, 9 F. Supp.2d
8 1119 (D. Neb. 1998) (“Jones II”). In that case, the IRS was held liable for \$4.5 million in
9 damages for making an unauthorized disclosure to an informant, who then further disclosed the
10 information he received from the IRS. Id. at 1153. The court in Jones II assessed damages
11 against the IRS, because it found that further disclosure by that informant was foreseeable to
12 the IRS. Jones II, 9 F. Supp.2d at 1143.¹⁴

13 Defendant argues that because the Jones cases involved a different exception
14 provision of the statute, the holding of Jones II is inapplicable to the instant case. The Court
15 disagrees. The Jones II court awarded damages not because of some particular feature of the
16 statutory exception on which the IRS relied, but rather, because it found that the IRS was at
17 least negligent because it should have foreseen that the informant would disclose tax return
18 information.

19 In the case at bar, any tax return or tax return information disclosed by the IRS to
20 a foreign tax authority in furtherance and under the authority of the Convention would
21 constitute an authorized disclosure falling into a category of information excepted from §
22

23
24 ¹⁴ In the predecessor case, Jones v. United States, 898 F. Supp. 1360 (D. Neb. 1995)
25 (“Jones I”), the Government advanced an argument that the disclosure to the informant was
26 authorized by 26 U.S.C. § 6103(k)(6), which authorizes disclosure for investigative purposes.
27 The Jones I court held that the disclosure was unauthorized by § 6103(k)(6). The court held
28 that the disclosure at issue “amounted to notification that the tax returns of [plaintiffs] were
‘subject to other investigation or processing,’ as defined by 26 U.S.C. § 6103(b)(2) [definition
of tax return information],” and therefore was prohibited by §7431(a) absent an exception. Id.
at 1379-80.

1 7431(a) by §6103(k)(4) only if the terms and conditions of the Convention were maintained.
2 Plaintiffs argue that the terms and conditions of the Convention were--at least negligently if
3 not knowingly--not maintained because the IRS should have foreseen that the NTA would
4 unlawfully disclose the return information to the press. Therefore, Plaintiff argues,
5 §6103(k)(4) does not excuse the IRS disclosures from the applicability of the anti-disclosure
6 statute.

7 At oral argument, Defendant argued that the Convention requires only that the NTA
8 maintain the secrecy and that the section on which Plaintiffs rely does not place on the IRS a
9 duty of assuring itself that the NTA will act in compliance with the Convention. The Court
10 disagrees. Section 6103(k)(4), expressly conditions the disclosure to the foreign government
11 on compliance with the terms of the Convention and such terms, which include secrecy, are
12 binding on both signatories. Consequently, if, as Plaintiffs allege, the IRS knew or should have
13 known, based on the alleged prior history of mutual relations with the NTA, that the latter
14 routinely fails to comply with the terms and conditions of secrecy mandated by the
15 Convention, the IRS's disclosure of any return information--whether true or false--to the NTA
16 was not authorized by the Convention nor by the statute.¹⁵

17 **C. Whether Plaintiffs' Count I is a "disguised" tort claim.**

18 In addition to the arguments discussed above, Defendant argues that Count I of
19 Plaintiffs' Complaint, entitled "Unauthorized Disclosure of False Information" should be
20 dismissed because it is, in fact, a claim for libel or slander disguised as an action for
21 unauthorized disclosure and, therefore, does not state a claim for unauthorized disclosure.
22 (Mot. at 13.) Defendant alleges that

23
24 ¹⁵ In its Motion to Dismiss for failure to state a claim, Defendant does not argue that
25 Plaintiffs' Complaint is lacking the two remaining elements of the claim for unauthorized
26 disclosure, i.e., causation of the injury and that the disclosure was knowing or negligent. In
27 light of Plaintiffs' allegations that some of the disclosed information was false and that the IRS
28 had knowledge of the NTA's propensity to leak information to the press, the Court finds no
deficiency in Plaintiffs' Complaint with respect to these two elements of Plaintiffs' claims for
unauthorized disclosure.

1 [P]laintiffs concede in paragraph 55 [of the Complaint] that this action
2 is not about disclosure of return information. That paragraph states:
3 “The false information released to the NTA would have, if true,
4 constituted returns and return information under the provisions of 26
5 U.S.C. § 6103(b)(1) and (2).” Simply put, according to [P]laintiffs
6 [C]omplaint, the information released from the IRS to the NTA--at
7 least the portion out of which [P]laintiffs are claiming damages--is not
8 tax return information.¹⁶

9 Id. Defendant further argues that because Count I alleges that the IRS knew or should have
10 known that the information it disclosed to the NTA was false and that dissemination of that
11 false information caused Plaintiffs’ damages, Plaintiffs’ claim in Count I sounds in tort. (Mot.
12 at 13.) “The Complaint makes it clear that the falsity of information disclosed has caused the
13 damages being claimed.” Id.

14 In Response, Plaintiffs argue that Defendant attempts to misconstrue their
15 argument, and that paragraph 55 of the Complaint does not support Defendant’s contention that
16 Plaintiffs’ Count I sounds in tort. That paragraph, Plaintiffs say, “is not an allegation or
17 admission by Plaintiffs that false information is not tax return information. It is simply an
18 allegation that the type of false information disclosed was that peculiar [sic]¹⁷ type of
19 information described in section 6103(b), i.e., return information. Plaintiffs certainly
20 acknowledge that false information can also constitute tax return information for purposes of
21 a section 7431 action, as is herein alleged.” (Resp. at 9.) Plaintiffs further points out that
22 “[w]hile disclosure of false information may be defamatory, this is not the gravamen of
23 Plaintiffs’ claim.” Id. Plaintiffs’ claim is that the disclosure of false information was not
24 authorized by the statute and that it caused Plaintiffs economic damages as well as emotional

25 ¹⁶ It is unclear which portion of the disclosed information Defendant characterizes as
26 “at least the portion out of which plaintiffs are claiming damages.” Under the statutory
27 definition of tax return information, and in light of the Court’s prior discussion, Plaintiffs
28 damages, if any are awarded, may result from disclosure of all the information disclosed by
the IRS to the NTA. The distinction between disclosure of false as opposed to actual return
information may be relevant only for the purpose of establishing scienter necessary for the
determination whether the alleged unlawful disclosures were made willfully and knowingly or
only negligently.

¹⁷ Plaintiffs probably meant to use the word “particular” rather than peculiar.

1 distress to the individual Plaintiffs. Id. Both types of damages are recoverable. Id.¹⁸

2 In Reply, Defendant argues that because under Arizona law, “[t]o be defamatory, a
3 publication must be false and must bring the defamed person into disrepute, contempt, or
4 ridicule, or must impeach plaintiff’s honesty or integrity, virtue or reputation,”¹⁹ and because,
5 in the case at bar, “[P]laintiffs allege that erroneous facts and conclusions from an IRS
6 examination were passed along to the NTA, when the IRS knew or should have known the
7 information was false, and that the communication of this information resulted in economic
8 damages to the [P]laintiffs,” Plaintiffs’ Count I “is a garden-variety defamation claim.” (Rpl.
9 at 10.) Further, Defendant states that because Plaintiffs made clear in their Response “that
10 they are not litigating whether alleged disclosures from the NTA to the Japanese press are
11 actionable under § 7431, the entire [C]omplaint, not just Count One, constitutes a disguised
12 action for libel or slander.”²⁰ (Rpl. at 10 n. 7.) The Court disagrees.

13 Merely because Plaintiffs claim damages to their business and/or personal reputation,
14 does not convert their unauthorized disclosure claim into a defamation claim, because the two
15 claims are not necessarily mutually exclusive. See Jones II, 9 F. Supp.2d 1119 (D. Neb. 1998)
16 (the obvious purpose of prohibiting unauthorized disclosures is to protect the personal and
17 business reputation of the taxpayer). Id. at 1143. Even if the elements of Plaintiffs’ claims
18 would fit the prima facie case for defamation under Arizona law, Defendant does not offer any
19

20 ¹⁸ In support of the damages argument, Plaintiffs cite Jones II, 9 F. Supp.2d at 1153,
21 which awarded plaintiff \$4.5 million for wrongful disclosure which caused the collapse of
22 Jones Oil Company; and \$325,000 in damages for emotional distress.

23 ¹⁹ Defendant quotes Olive v. City of Scottsdale, 969 F. Supp. 564, 575 (D. Ariz. 1996)
24 and cites Turner v. Devlin, 848 P.2d 286, 288-89 (Ariz. 1993) (en banc). Neither of the two
25 cases involved a disclosure of unauthorized information by a government agency to a foreign
26 government agency and a resultant publication in the mass media. The former case involved
27 plaintiffs’ claim for defamation due to defendants’ reporting of the suspected sexual
28 harassment. The latter involved an allegedly false report of a misconduct by a police officer.

²⁰ It is unclear how Defendant arrived at this conclusion, but Defendant offers no
authority for the proposition that disclosure of actual as opposed to false information, may
be actionable as libel or slander.

1 authority for the proposition that a defamation claim under state law is Plaintiffs' exclusive
2 remedy and that Plaintiffs are precluded from bringing a claim for alleged unauthorized
3 disclosure under a federal statute.

4 Taking all the reasonable inferences in Plaintiffs' favor as the Court must on this Motion
5 to Dismiss, the Court finds that the factual allegations of Plaintiffs' Complaint, if proven,
6 would support Plaintiffs' claim for unauthorized disclosure under § 7431. Consequently,
7 Defendant's Motion to Dismiss for failure to state a claim will be denied.

8 Accordingly,

9 **IT IS ORDERED** that Defendant's Motion to Dismiss Plaintiffs' Complaint for failure
10 to state a claim is denied.

11 **IT IS FURTHER ORDERED** that Defendant's Motion to Dismiss Plaintiffs'
12 Complaint as untimely (Doc. # 13) is granted without prejudice.

13 **IT IS FURTHER ORDERED** that Plaintiffs' Motion for Leave to Amend the
14 Complaint made at oral argument is granted. Plaintiffs may file an Amended Complaint setting
15 forth factual basis in support of the timeliness of their action, as explained in this Order, on
16 or before October 2, 2000.

17 DATED this _____ day of September, 2000.

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Roslyn O. Silver
United States District Judge

22 Cc. all counsel of record.
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